

STATE and TRIBAL ROYALTY AUDIT COMMITTEE

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• Navajo Nation • State of New Mexico
State of North Dakota • State of Oklahoma • Shoshone & Arapaho Tribes • Southern Ute Indian Tribe • State of Texas
State of Utah • Ute Indian Tribe • Ute Mountain Ute Tribe • State of Wyoming

Lisa Dockter, *Chair* (970) 563-5559
Dennis R. Roller, *1st Vice Chair* (701) 250-4682
Brenda Petersen, *2nd Vice Chair* (303) 355-0400

Former Chair, Ex Officio:
Joe Vintz

Mr. Dennis Roller
Audit Manager
North Dakota State Auditor's Office
Royalty Audit Section
P.O. Box 3009
Bismarck, ND 58502-3009

Dear Mr. Roller:

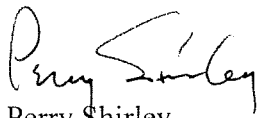
We have completed a review of the North Dakota State Auditor's Office, Royalty Audit Section's system of quality control. The purpose of the review was to obtain a reasonable assurance of compliance with generally accepted government auditing standards in effect for the Royalty Audit Section for audits issued during the period of July 1, 2003 through June 30, 2006. We conducted the review in conformity with the policies and procedures for quality control peer reviews established by the Peer Review Standards Subcommittee of the State and Tribal Royalty Audit Committee (STRAC). We tested the North Dakota Royalty Audit Section's compliance with the system of quality control policies and procedures to the extent we considered necessary under the circumstances. These tests included the application of the North Dakota Royalty Audit Section's policies and procedures to selected audit engagements.

In performing our review, we have given consideration to the general characteristics of a system of quality control as described in the quality control peer review guidelines issued by the Peer Review Standards Subcommittee. Such a system should be appropriately comprehensive and suitably designed in relation to the North Dakota Royalty Audit Section's organizational structure, its policies, and the nature of its functions.

Because variance in individual performance can affect the degree of compliance with the North Dakota Royalty Audit Section's prescribed quality control policies and procedures, adherence to all policies and procedures in every case may not be possible. Nevertheless, compliance does require the North Dakota Royalty Audit Section to adhere to prescribed policies and procedures in most situations.

In our opinion, the system of quality control provided reasonable assurance of compliance with generally accepted government auditing standards for the Royalty Audit Section of the North Dakota State Auditor's Office, for audits issued during the period July 1, 2003 through June 30, 2006. Furthermore, the system of quality control in effect for this period, met the objectives of the quality control peer review guidelines established by the Peer Review Standards Subcommittee of STRAC.

April 23, 2007



Perry Shirley
Team Leader
Navajo Nation



Nema Harrison
Team Member
Blackfeet Nation

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April 23, 2007

Mr. Dennis Roller, Audit Manager
State of North Dakota
Office of the State Auditor
Royalty Audit Section
P.O. Box 3009
Bismarck, North Dakota 58502-3009

RE: Opportunities for Improvement Management Letter
Peer Review Period: July 1, 2003 through June 30, 2006

Dear Mr. Roller:

The Navajo Nation and Blackfeet Indian Tribe have completed a review of the State of North Dakota, Office of the State Auditor, Royalty Audit Section's system of quality control for audits performed during the period July 1, 2003 through June 30, 2006. The purpose of the review was to obtain a reasonable assurance of compliance with generally accepted government auditing standards as issued by the Comptroller General of the United States. We have issued a Peer Review report dated April 20, 2007, in conjunction with the content of this letter.

The goal of the State and Tribal Royalty Audit Committee peer review program is to foster quality audits by States and tribes through an independent assessment of their quality control policies and procedures and compliance with applicable auditing standards. Overall, we found that quality control procedures existed and requirements were being complied with in the performance of audits.

During the Peer Review, we noted several areas of the audit work where improvements could be achieved. Although the noted areas do not constitute material weaknesses, reportable conditions, and do not result from consistent or material noncompliance with established standards that would require a qualified or adverse opinion, they do in our opinion, represent areas where improvements could be made. The following is a discussion of opportunities for potential improvement for the State of North Dakota, Office of the State Auditor, Royalty Audit Section.

The audit cases for the review were selected based upon closure dates that were subsequent to the issuance of the most recent Internal Quality Control Review (IQCR) performed by the U.S. Minerals Management Service. The rationale was that these audits would be a representative of current work performed by North Dakota. Furthermore, this would also provide us with a means of evaluating the State of North Dakota's responsiveness to matters identified in the IQCR report issued on July 6, 2006. It should be noted that the STRAC Peer Review is a separate and mutually exclusive review from MMS' IQCR process; however, it is also prudent to acknowledge that appropriate Peer Review actions should be taken to eliminate duplication in the scope of the review to lessen the burden on the North Dakota delegation and for efficiency purposes.

In our review of the prior IQCR, we noted that the MMS had determined that all State and Tribal royalty audit delegations would be required to adhere to two (2) areas wherein North Dakota's Royalty Audit Section had questioned certain IQCR findings. Those IQCR findings relate to: 1) the extent of the frequency of supervisory reviews throughout the audit process; and 2) the extent of providing a purpose, source, scope, conclusion and identification of the auditor on "every" workpaper in an audit file. MMS places reliance on its Audit Manual and a determination made by its "peer review contractor" in its decision to ensure that supervisory reviews are performed in a timely (continuous) manner throughout the audit planning, field work, and audit completion (reporting) process. This is irrespective of the guidelines set forth in the GAS 7.47 pertaining to characteristics of audit organizations in fulfilling the supervisory (periodic) review of audit workpaper requirements.

Furthermore, MMS by issuance of its IQCR to North Dakota has determined that its Audit Manual at Section 10.3 and the North Dakota cooperative agreement language at Section C,C.4,d(1), supercede audit documentation guidelines referenced under GAS 7.68. As such, MMS provides that North Dakota's Royalty Audit Section is notified that it must maintain copies of all source documents received from companies in accordance with MMS' Audit Manual.

It is noted by the reviewers that both of these aforementioned situations were prevalent in our review of audit files pertaining to 1) Southwest Royalties, Inc. CIM# 06-000700.001 and 2) Choctaw II Oil and Gas, LTD.

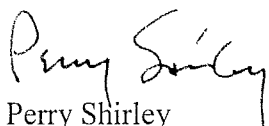
In addition, the following matters were noted with the recommendations provided:

1. A copy of the audit program was included in the audit file; however, it was only noted as being "reviewed" and not as being "approved". The audit programs should be documented as specifically being "approved" by the audit supervisor/manager.
2. Audit file documentation procedures should include actual copies of applicable CFR regulations, policies, etc. for audit issue(s) identified. It should be noted that this matter was also identified in the management letter dated December 4, 2003, under the previous Peer Review.

3. Documentation of assessment of Management Controls could not be located in the audit case file. Such Management Control assessments (s) should be documented in the audit case files.
4. The Yellow Book requires that auditors responsible for planning, directing, conducting, or reporting on government audits should complete, every 2 years, at least 80 hours of continuing professional education (CPE) and training which contributes to the auditor's professional proficiency. Three staff auditors "may" not meet CPE requirements due to reliance on CPE credit hours from previously issued CPE certificates for participation in various STRAC meeting(s). However; it is noted that the three (3) affected audit staff are scheduled to participate in the Rocky Mountain Mineral Law Foundation's Federal and Indian Royalty Valuation Institute scheduled on February 28, 2007 to March 2, 2007, which should provide sufficient CPE to meet the requirements for 2005-2006.
5. The annual performance appraisal was not completed for Mr. Dennis Roller, Audit Manager, for the most current period of June 16, 2005 through June 15, 2006. An appraisal should be completed and steps put in place to assure that the appraisals for Royalty Audit Section staff are completed.
6. North Dakota management should implement follow-up procedures to ensure that it receives written approval from MMS on its annual workplan modifications. It should be noted that MMS also has a responsibility to respond to such requests without continual follow up from North Dakota.
7. While every audit program has a unique method of audit file organization, an overall audit case file index would be beneficial to provide more clarity to the organization of the audit workpapers for the North Dakota Royalty Audit Section. It is also noted that the benefits of a simple, concise and understandable indexing system was previously addressed in the Management Letter dated December 4, 2003.

In conclusion, we were impressed with the program's professionalism and competence.

Sincerely,



Perry Shirley
Lead Reviewer
Navajo Nation



Nema Harrison
Reviewer
Blackfeet Nation